COURSE LEARNING OUTCOMES

At the end of this course the students will be able to

CLO 2 Assess the concept of Redemption of shares, debentures, underwriting of shares and underwriter’s liability.

Preview of last class

01 **Meaning of Firm Underwriting**

02 **When the Issue is Fully Underwritten**

03 **Steps in determining the liability of individual underwriter**

Topics Covered

- **Model Problems with solution in Firm Underwriting**

COMPLETE & PARTIAL UNDERWRITING PROBLEMS - LECTURE VIDEO

SOURCE

https://www.youtube.com/watch?v=XDsb56KKXYU

https://www.youtube.com/watch?v=AQ_GmE2ZaTU

https://www.youtube.com/watch?v=jK4KNnvFnMU&t=788s

https://www.youtube.com/watch?v=QSLXdWjgtiQ

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SOURCE : Animation

- by Mr. Saheb Academy, Educational Channel, IPCC.

- by Mrs. Kauser Wise, Youtube Pedogogy, Chennai

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Firm underwriting Model Problem - 1

1) A joint stock company resolved to issue 10 lakh equity shares of Rs. 10 each at a premium of Re. 1 per share. Two lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications. The issue was underwritten by X, Y and Z for a commission @ 2.5% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows : X 30,000 shares, Y 20,000 shares and Z 10,000 shares.

Firm underwriting Model Problem - 1

Contd.,

The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public. Marked applications were as follows: X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares. Unmarked applications totaled 6,00,000 shares. Accounts with the underwriters were promptly settled.

You are required to:

(i) Prepare a statements calculating underwriters' liability for shares other than shares underwritten firm.

(ii) Pass journal entries for all the transactions including cash transactions.

Firm underwriting - Solution

Answer

Statement showing underwriters' liability for shares other than shares underwritten firm

	X	*Y*	*Z*	*TOTAL*
Gross liability (Issued shares – purchased by promoters, directors etc. (8,00,000 shares in the ratio of 65 : 25 : 10)	5,20,000	2,00,000	80,000	8,00,000
Less : Marked applications	(1,19,500)	(57,500)	(10,500)	(1,87,500)
	4,00,500	1,42,500	69,500	6,12,500

Firm underwriting - Solution

Less : Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the ratio 65 : 25 : 10	(3,90,000)	(1,50,000)	(60,000)	(6,00,000)
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	(6,500)	7,500	(1,000)	-
Additional shares to be purchased by X & Z	4,000	-	8,500	12,500

Firm underwriting - Solution

Additional Liability for additional shares@ Rs. 11	44,000	-	93,500
Underwriting commission payable on Gross Liability (Shares underwritten as Gross liability × 11 × 2.5%)	(1,43,000)	(55,000)	(22,000)
Net Amount payable/receivables	(99,000)	(55,000)	71,500

Firm underwriting - Solution

(ii) **Journal Entries**

Particulars		*Dr.*	*Cr.*
Bank A/c	Dr.	22,00,000	
To Equity Shares Application A/c			22,00,000
(Being application money received on 2 lakh equity shares purchased by directors etc. @ Rs. 11 per share)			
Bank A/c	Dr.	86,62,500	
To Equity Share Application A/c			86,62,500
(Application money received on 7,87,500 equity shares @ Rs. 11 per share from general public and underwriters for shares underwritten firm)			
Equity Share Application A/c	Dr.	1,08,62,500	
X' s A/c	Dr.	44,000	
Z' s A/c	Dr.	93,500	
To Equity Share Capital A/c			1,00,00,000
To Securities Premium A/c			10,00,000
(Allotment of 10 lakh equity shares of 10 each at a premium of Rs. 1 per share)			

Firm underwriting - Solution

Underwriting commission A/c	Dr.	2,20,000	
To X's A/c			1,43,000
To Y's A/c			55,000
To Z's A/c			22,000
(Amount of underwriting commission payable to X, Y and Z @ 2.5% on the amount of shares underwritten)			
Bank A/c	Dr.	71,500	
To Z's A/c			71,500
(Amount received from Z in final settlement)			
X's A/c	Dr.	99,000	
Y's A/c	Dr.	55,000	1,54,000
To Bank A/c			
(Amount paid to X and Y in final settlement)			

Firm underwriting Model Problem – 2

2) Suprima Ltd. came out with an issue of 45,00,000 equity shares of 10 each at a premium of Rs. 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co. Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below: Shares A & Co. 8,00,000 B & Co. 7,00,000 C & Co. 13,75,000 Total 28,75,000 The underwriters are eligible for a commission of 3.5% on face value of shares. The entire amount towards shares subscription has to be paid along with application.

Firm underwriting Model Problem – 2

Contd.,

You are required to:

(a) Compute the underwriters' liabilities (number of shares)

(b) Compute the amounts payable or due to underwriters; and (c) Pass necessary journal entries in the books of Suprima Ltd. relating to underwriting.

Firm underwriting - Solution

Answer

(a) Computation of liabilities of underwriters (No. of shares)

	A & Co.	*B & Co*	*C & Co.*
Gross liability (Total Issue – shares purchased by promoters, directors, employees etc)	12,00,000	12,00,000	12,00,000
Less : Firm underwriting	(1,00,000)	(1,00,000)	(1,00,000)
	11,00,000	11,00,000	11,00,000
Less : Marked applications	(8,00,000)	(7,00,000)	(13,75,000)
Unmarked applications	3,00,000	4,00,000	(2,75,000)
Less : Unmarked applications distributed to A & Co. and B & Co. in equal ratio	(1,12,500)	(1,12,500)	Nil
Total unmarked applications	1,87,500	2,87,500	(2,75,000)

Firm underwriting - Solution

Less : Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	(1,05,000)	(1,05,000)	2,10,000
Net liability (excluding firm underwriting)	82,500	1,82,500	Nil
Add : Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	1,82,500	2,82,500	1,00,000

Total Subscriptions received for 31,00,000 Shares out of which marked shares were Rs. 28,75,000, Hence unmarked shares received were 2,25,000 shares which will be distributed between A & Co and B & Co only equally (agreed ratio underwriting). C & Co has already exceeded the underwriting limit hence will not be required to absorb unmarked shares.

No of shares purchased by Underwriters collectively will be 5 Lakh shares as under:

Total Shares Issued	45,00,000
Less: Purchased by Promoters etc	9,00,000
Shares offered to the Public	36,00,000
Total Subscription received	31,00,000
Shares purchased by Underwriters including firm commitment	5,00,000

Firm underwriting - Solution

(b) Computation of amounts payable by underwriters:

	A & Co	*B & Co*	*C & Co*
Liability towards shares to be subscribed@ 12 per share	21,90,000	33,90,000	12,00,000
Less : Commission (on Gross Liability) (3.5% on FV Rs. 10 each on 12 lakhs shares	(4,20,000)	(4,20,000)	(4,20,000)
Net amount to be paid by underwriters	17,70,000	29,70,000	7,80,000

(c) In the Books of Suprima Ltd. Journal Entries

Particulars		*Dr.*	*Cr.*
Underwriting commission A/ c	Dr.	12,60,000	
To A & Co. A/c			4,20,000
To B & Co. A/c			4,20,000
To C & Co. A/c			4,20,000
(Being underwriting commission on the shares underwritten)			

Firm underwriting - Solution

A & Co. A/ c	Dr.	21,90,000	
B & Co. A/ c	Dr.	26,10,000	
C & Co. A/c	Dr.	12,00,000	
To Equity share capital A/c			50,00,000
To Share premium A/c			10,00,000
(Being shares including firm underwritten shares allotted to underwriters)			
Bank A/ c	Dr.	55,20,000	
To A & Co. A/c			17,70,000
To B & Co. A/c			29,70,000
To C & Co. A/c			7,80,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)			

Firm underwriting Model Problem – 3

3) ‘X’ Ltd., issued 1,00,000 equity shares of Rs. 10 each at par. The entire issue was underwritten as follows: A – 60,000 shares (Firm underwriting 8,000 shares) B – 30,000 shares (Firm underwriting 10,000 shares) C – 10,000 shares (Firm underwriting 2,000 shares) The total applications including firm underwriting were for 80,000 shares. The marked applications were as follows: A- 20,000 shares; B- 14,000 shares; C- 6,000 shares. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten. Determine the liability of each underwriter.

Firm underwriting - Solution

Answer

Statement showing liability of underwriters

	A	*B*	*C*	*Total*
Gross Liability (Total Issue – purchase by promoters etc)	60,000	30,000	10,000	1,00,000
Less : Firm underwriting	(8,000)	(10,000)	(2,000)	(20,000)
	52,000	20,000	8,000	80,000
Less : Marked applications	(20,000)	(14,000)	(6,000)	(40,000)
	32,000	6,000	2,000	40,000
Less : Unmarked applications (total application less firm underwriting less marked applications) in gross liability ratio (Unmarked Applications = (80,000 – 20,000 – 40,000)=20,000	(12,000)	(6,000)	(2,000)	(20,000)
Net Liability	20,000	-	-	20,000
Add : Firm underwriting	8,000	10,000	2,000	20,000
Total liability of underwriters	28,000	10,000	2,000	40,000
Total Liability in Amount @ Rs.10/-	2,80,000	1,00,000	2,00,000	4,00,000

Firm underwriting Model Problem – 4

4) Dolly Ltd. issued 25,00,000 equity shares of Rs.10 each at par. 10,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters P, Q & R in the ratio of 2 : 4 : 4 with firm underwriting of 50,000, 60,000 and 70,000 shares each respectively. Total subscription received 12,88,000 shares including marked application and excluding firm underwriting. Marked applications were as follows: P 3,00,000 Q 3,50,000 R 4,50,000 Unmarked and surplus applications to be distributed in gross liability ratio. Ascertain the liability of each underwriter.

Firm underwriting - Solution

Answer

Calculation of liability of underwriters (In shares)

	P	*Q*	*R*	*Total*
Gross Liability (Total Issue – purchase by promoters etc.)	3,00,000	6,00,000	6,00,000	15,00,000
Less : Firm underwriting	(50,000)	(60,000)	(70,000)	(180,000)
	250,000	540,000	530,000	13,20,000
Less Marked applications	(3,00,000)	(350,000)	(450,000)	(11,00,000)
	(50,000)	190,000	80,000	220,000
Less : Unmarked applications (In gross liability ratio 4:6:8)	_	(94,000)	(94,000)	(188,000)
Net Liability	(50,000)	94,000	(14,000)	32,000

Firm underwriting - Solution

Excess of P and taken over by Q	50,000	62,000	14,000	-
Net liability (other than firm underwriting)	-	32,000	-	32,000
Add : Firm underwriting	50,000	60,000	70,000	1,80,000
Total liability of underwriters including firm underwriting	50,000	92,000	70,000	2,12,000
Total Liability in Amount @ Rs. 10/-	5,00,000	9,20,000	7,00,000	41,20,000

Firm underwriting Model Problem – 5

5) ABC Ltd. came up with public issue of 3,00,000 Equity Shares of Rs.10 each at Rs. 15 per share. P, Q and R took underwriting of the issue in ratio of 3 : 2: 1 with the provisions of firm underwriting of 20,000, 14,000 and 10,000 shares respectively. Applications were received for 2,40,000 shares excluding firm underwriting. The marked applications from public were received as under: P - 60,000 Q - 50,000 R - 60,000 Compute the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of firm underwriting is not given to individual underwriters.

Firm underwriting - Solution

Answer

Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is not given to individual underwriters

	P	*Q*	*R*	*Total*
Gross Liability (Total Issue – purchase by promoters etc.)	150,000	1,00,000	50,000	3,00,000
Less : Marked applications (excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(170,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less : Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
	84,000	46,000	-	1,30,000
Less : Unmarked applications including firm underwriting (Refer W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	232,000

Firm underwriting - Solution

Less : Surplus of R allocated to P and Q in the ratio of 3:2	11,400	(7,600)	19,000	
Net liability (other than firm underwriting)	15,600	400	-	16,000
Add : Firm underwriting	20,000	14,000	10,000	44,000
Total liability of underwriters including firm underwriting	35,600	1,4,400	10,000	60,000

Working Note:

Applications received from public 2,40,000 shares

Add : Shares underwritten firm (20,000 + 14,000 + 10,000) 44,000 shares

Total applications 2,84,000 shares

Less : Marked applications (60,000 + 50,000 + 60,000) (1,70,000 shares)

Unmarked applications including firm underwriting 1,14,000 shares

Firm underwriting Model Problem – 6

6) A company issued 1,50,000 shares of Rs. 10 each at a premium of Rs. 10. The entire issue was underwritten as follows: X – 90000 shares (Firm underwriting 12000 shares) Y – 37500 shares (Firm underwriting 4500 shares) Z – 22500 shares (Firm underwriting 15000 shares) Total subscriptions received by the company (excluding firm underwriting and marked applications) were 22500 shares. The marked applications (excluding firm underwriting) were as follows: X – 15000 shares Y – 30000 shares Z – 7500 shares Commission payable to underwriters is at 5% of the issue price.

Firm underwriting Model Problem – 6

Contd.,

The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

(i) Determine the liability of each underwriter (number of shares);

(ii) Compute the amounts payable or due from underwriters; and

(iii) Pass Journal Entries in the books of the company relating to underwriting.

Firm underwriting - Solution

Answer

(i) Computation of total liability of underwriters in shares (In shares)

	X	*Y*	*Z*	*Total*
Gross Liability (Total Issue – purchase by promoters etc.)	90,000	37,500	22,500	1,50,000
Less : Marked applications (excluding firm underwriting)	(15,000)	(30,000)	(7,500)	(52,500)
	75,000	7,500	15,000	97,500
Less : Unmarked applications (In gross liability ratio 12:5:3)	(13,500)	(5,625)	(3,375)	(22,500)
	61,500	1,875	11,625	75,000
Less : Firm underwriting	(12,000)	(4,500)	(15,000)	(31,500)
Balance	49,500	(2,625)	(3,375)	43,500

Firm underwriting - Solution

Less : Surplus of Y and Z adjusted in X's balance (2,625+3,375)	(6,000)	2,625	3,375	
Net liability	43,500	-	-	43,500
Add : Firm underwriting	12,000	4,500	15,000	31,500
Total Liability	55,500	4,500	15,000	75,000

Firm underwriting - Solution

(ii) Calculation of amount payable to or due from underwriters

	X	*Y*	*Z*	*Total*
Total liability	55,500	4,500	15,000	75,000
Amount receivable @ Rs. 20 from underwriter (in Rs.)	11,10,000	90,000	3,00,000	15,00,000
Less : Underwriting Commission payable @ 5% of Rs. 20 (in Rs.)	(90,000)	(37,500)	(22,500)	(1,50,000)
Net amount receivable (in Rs.)	10,20,000	52,500	2,77,500	13,50,000

Firm underwriting - Solution

(iii) Journal Entries in the books of the company (relating to underwriting)

Sl. no.	*Particular*		*Dr.*	*Cr.*
1	X	Dr.	11,10,000	
	Y	Dr.	90,000	
	Z	Dr.	3,00,000	
	To Share Capital A/c			7,50,000
	To Securities Premium A/c			7,50,000
	(Being allotment of shares to underwriters)			
2	Underwriting commission A/c	Dr.	1,50,000	
	To X			90,000
	To Y			37,500
	To Z			22,500
	(Being amount of underwriting commission payable)			

Firm underwriting - Solution

3	Bank A/c	Dr.	13,50,000	
	To X			10,20,000
	To Y			52,500
	To Z			2,77,500
	(Being net amount received by underwriters for shares allotted less underwriting commission)			

Test Your Knowledge

LINK

https://docs.google.com/document/d/1PUnU982WNTP3Ahsj0rT0qU-WtfGIbR2pCgiq6saKbrU/edit?usp=sharing

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THANK YOU